Facing the Foreclosure Crisis:

Four Urgent Needs to Address Now.

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On November 17, 2011, Center for Responsible Lending published new research that shows that the nation is not even halfway through the foreclosure crisis. *Lost Ground, 2011: Disparities in Mortgage Lending and Foreclosures* finds that: (1) foreclosure rates are closely tied to harmful loan terms, and (2) the majority of foreclosures have been experienced by white households, though African-American and Latino families have suffered a disproportionate share of home losses. Differences in income and credit scores do not explain why the foreclosure crisis has hit communities of color harder.

Lost Ground, 2011

CRL's recent research report, "Lost Ground, 2011: Disparities in Mortgage Lending and Foreclosures," shows that we are not even halfway through the foreclosure crisis. Here we discuss practical policies that would help stop the foreclosure epidemic and restore confidence in the housing market.

For new mortgages, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 addresses the core problems of risky underwriting and abusive loan terms that led to this crisis. Unfortunately, flawed mortgages made prior to reform and high unemployment rates have combined to fuel a continuous flow of foreclosures. Voluntary efforts by mortgage loan servicers have not been effective in stopping the foreclosure epidemic. Mortgage servicers have been embroiled in legal battles related to improper and sometimes fraudulent handling of delinquent loans and foreclosures.

Policymakers currently have four urgent needs to address: (1) stopping foreclosures now, (2) implementing lending rules that would prevent another crisis, (3) maintaining a housing finance system that builds wealth and ensures access to credit for creditworthy borrowers, and (4) confirming the director for the Consumer Financial Protection Bureau.

I. Keep families in their home when reasonable loan modifications are possible, and reform the broken loan servicing industry.

The *Lost Ground, 2011* report finds that 2.7 million people who received mortgages between 2004 and 2008 had already lost their homes to foreclosure and an additional 3.6 million households were still at immediate, serious risk of doing so. According to Amherst Securities, we may have a stunning 10 million more foreclosures ahead.[1] Many of these foreclosures can be prevented if policymakers stop relying on voluntary efforts and instead require servicers to make reasonable modifications on mortgages that have a good chance for success.

[1] *See* "Testimony of Laurie S. Goodman, Amherst Securities Group to the Subcommittee on Housing, Transportation and Community Development of the Senate Committee on Banking, Housing and Urban Affairs. Topic— New Ideas to Address the Glut of Foreclosed Properties, (September 20, 2011) at 2, *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=dc3d9918-5aca-47b2-9ce4-b9daaef67957. The Amherst study relies on a broader set of loans than the 2004-2008 dataset used in the recent CRL report.

- Policymakers should apply strong, mandatory standards for loan modifications. States can require loan servicers to take specific steps to avert foreclosures prior to foreclosure ("loss mitigation"), and there is an urgent need for federal actors to establish national loss mitigation standards. Standards should target appropriate levels of debt (the debt-to-income ratio) for eligible homeowners and bar unreasonable fees. Some effective state loss mitigation efforts, and future settlements and consent orders between banks and regulators, can offer examples of standards that could apply to servicing nationally.

- End loan servicing abuses and poor business practices that contribute to unnecessary foreclosures. Federal regulators should prohibit common servicer abuses, including misapplied payments, illegitimate fees, failure to pay escrowed taxes and insurance, force-placing overpriced insurance, obstructing refinances and modifications, and improperly pursuing foreclosure when at the same time working with borrowers on loan modifications. New York's recent laws and regulations provide a useful framework.[2]

- Lowering mortgage balances (principal reductions) is an essential tool for stopping the foreclosure epidemic. Housing experts are reaching a consensus that we need principal reductions for many underwater borrowers at imminent risk of foreclosure to stabilize the housing market. Modifications that reduce principal and are net present value positive to investors would enhance income streams for investors[3] and servicers while keeping families in homes and prevent further foreclosures from flooding an already saturated housing market. Given the high share of loans held by Fannie Mae and Freddie Mac, the Federal Housing Finance Agency should permit meaningful principal reductions on loans that are at imminent risk of foreclosure.

- Congress should fund more housing counseling and legal aid assistance for homeowners at risk of foreclosure. Studies have shown that homeowners who receive counseling are less likely to default on their loan. Every successful loan workout that prevents an unnecessary foreclosure helps homeowners, their communities and our economy as a whole.

II. Implement strong and sensible lending rules.

Lost Ground, 2011 shows that mortgage defaults are strongly tied to abusive loan terms, such as prepayment penalties, "exploding" adjustable-rate mortgages, and loans originated by mortgage brokers, which generally included kickbacks for placing borrowers in riskier, more expensive loans than borrowers qualified for. The Dodd-Frank Act addresses these abuses directly, and requires lenders to ensure a borrower's ability to repay the loan. Policymakers should resist efforts to weaken these reforms.

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[2] *See* 3 CRR-NY III B 419 **"**Servicing Mortgage Loans: Business Conduct Rules," *available at* http://www.banking.state.ny.us/legal/ar419tx.htm . *See also* NY Banking Law §12-D.

[3] While Fannie Mae and Freddie Mac are in conservatorship, "investors" also include U.S. taxpayers.

- The Consumer Financial Protection Bureau (CFPB) should implement the Dodd-Frank lending rules, including the common-sense requirement to ensure ability to repay. For the rules to work, they must apply to everyone and cannot immunize lenders from accountability for loans made recklessly or in bad faith, even for "Qualified Mortgages" — loans presumed to meet the "ability to repay" standard.

- Congress should reject any attempts to weaken protections against predatory lending. For example, there are efforts to allow lenders to exclude certain fees when determining whether a loan is classified as "high cost." Excluding these fees would in some cases effectively circumvent basic legal protections for riskier, high-cost loans. Such protections are based on successful state laws—laws that do not hamper access to sustainable credit nor increase the cost of such credit.

III. Support programs that build wealth and maintain access to affordable credit.

Foreclosures have been particularly hard on low-wealth families who had the most to gain from sustainable homeownership. As we rebuild the mortgage credit market, we must recognize not only the current challenges but also the broader historical barriers to access to credit in this country. For decades, owning a home has been the most accessible way to build wealth and gain a foothold in the middle class. Especially for lower-income families and middle-class borrowers of color, this crisis threatens to undo decades of economic, social and educational progress. In our efforts to stabilize the housing market and prevent a future crisis, we must not create an environment where qualified borrowers are denied access to reasonably-priced mortgages.

- Financial regulators and Congress should reject proposals that impose high down payment requirements, along with highly restrictive debt-to-income ratios and credit standards. A key debate on these issues centers on the definition of "Qualified Residential Mortgages (QRMs)," which are mortgages lenders will be allowed to originate and sell as securities without being required to retain any of the risk. Current regulatory proposals for defining QRM include onerous down payment requirements that would unnecessarily prevent creditworthy families from buying a home. In fact, if QRM is defined too narrowly, it could effectively create a two-tiered mortgage market, relegating low- and moderate-income borrowers to higher-priced mortgages or leaving them without any mortgage options at all. Well-underwritten low down payment mortgages have been made successfully for decades; creditworthy borrowers who can afford to repay their loans should not be barred from credit on fair terms simply because they lack the wealth for substantial down payments.

- Congress and regulators should support initiatives that create sustainable homeownership. Examples include the Federal Housing Administration's critical low-down-payment loans, community development and neighborhood stabilization programs, housing counseling programs and a modernized Community Reinvestment Act.

- Congress should embrace a reformed housing finance system that ensures qualified borrowers have access to home loans while providing continued support for financing affordable rental housing. The system should provide equal access and control for responsible lenders of all sizes, including community banks and credit unions. To stabilize the market, facilitate access to capital and avoid the mistakes of the past, this system requires an effective, and fully paid for, governmental backstop.

IV. Don’t impair regulators’ ability to protect the market--confirm the CFPB's director.

The Dodd-Frank Act created the CFPB as an independent agency with the mission of protecting consumers from abusive financial practices. Some members of Congress are working to dismantle this new agency even as it works to get up and running. The CFPB is an essential component of the new mortgage and consumer finance markets–without this strong regulatory presence long-term recovery will be at risk. Rather than obstruct the CFPB, Congress should move swiftly through the confirmation process and let it protect consumers and rebuild confidence in the mortgage market.

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For more information and analysis about the foreclosure situation and a copy of our “Lost Ground, 2011” research, go to http://rspnsb.li/vNtV2t. Resources include state and metropolitan area data on completed foreclosures and serious delinquencies.

About the Center for Responsible Lending

The Center for Responsible Lending is dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is a national nonprofit, nonpartisan research and policy organization that promotes responsible lending practices and access to fair terms of credit for low-wealth families.

For more information, please visit our website at **www.responsiblelending.org**.